

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

To be argued by
JULES V. SPECINER

75-5005

United States Court of Appeals

FOR THE SECOND CIRCUIT

Case No. 75-5005

In the Matter

—of—

AVIEN, INC.,

B
EB
Debtor.

THE CITY OF NEW YORK,

Appellant,

—against—

AVIEN, INC.,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

BRIEF OF APPELLEE-DEBTOR AVIEN, INC.

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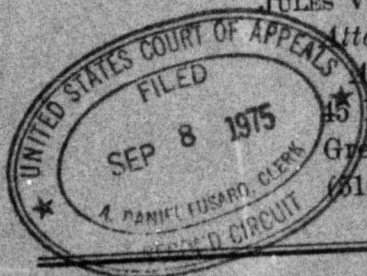


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Statement

Appellee-debtor accepts the Appellant's statement as satisfactory.

Statement of Issues

Appellee-debtor accepts Appellant's statement of such questions.

Statement of the Case

Appellee-debtor accepts Appellant's statement of the case.

Argument

Both lower court decisions (District Court and Bankruptcy Court) correctly held that the debtor-appellee is entitled to carry-back and carry-forward net operating losses for the years 1966, 1969 and 1970, thereby offsetting any 1968 profit and negating any New York City corporation tax.

The essence of this appeal is the construction of and application of the net operating loss deduction. (The pertinent statutory provisions are set forth at length in appellant's brief and are not herein repeated.) The City takes the position:

1) That the debtor, pursuant to Section 172 of the Internal Revenue Code, was mandated to carry over its net operating loss for the year 1963 as the earliest carryover year; and

2) That Section R46-2.0(8)(a) of the Administrative Code mandates that a net operating loss deduction be the same as the net operating loss deduction allowed under Section 172 of the Internal Revenue Code.

The untenable nature of the City's position was best summarized by Bankruptcy Judge Parente when he noted (49a) that:

"Patently, the City's strict construction of the foregoing statute places the debtor on the horns of a dilemma

and to put it in the vernacular—"the debtor is damned if he does and damned if he doesn't". Adoption of the City's narrow construction is tantamount to recognition of *draconian law* whereby the debtor is enmeshed by a trap of language and proffered an impotent remedy. Sanction of such viewpoint could conceivably bar carryover of tax losses for an optimum period of five years." *In re Avien, Inc.*, 70-B-1085 (E.D.N.Y. June 18, 1974). (Emphasis added.)

This Court has on other occasions seen fit to construe and give effect to an admittedly "draconian law." *Bruns, Nordeman & Co. v. American National Bank & Trust Co.*, 394 F.2d 300 (2d Cir. 1968).

However, it is a far different matter to so decide when the effect is that of a temporary procedural bar, rather than a final substantive bar on the merits.

The Internal Revenue Code in Section 172 provides for a net operating loss deduction by combining loss carryovers and loss carrybacks. The operating loss for a given year may be carried back for three years to the third year preceding the year of loss. The unused portion is then carried back to the second year preceding the loss and any remaining unused portion is carried to the year immediately prior to the loss year. Any portion still remaining may be carried forward for as many as five years after the year of loss. Yet as Judge Parente correctly noted (and conceded by appellant in its brief at page 36), adoption of the City's position could conceivably bar the carryover for the optimum five year period.

One has to search far and wide through a myriad of irrelevant factual and hypothetical situations in the appel-

lant's brief in order to ascertain the City's real concern—the City's fear that adoption of the debtor's contention would require the City to undertake a “vast program of enforcement and audit.” The District Court best laid to rest this argument as any basis for a decision herein (59a):

“However convenient conformity may be for administration, in construing legislation the court is bound to give effect to its primary purpose, even if to do so the court must depart from a literal reading of the legislation (citing cases). Manifestly, the intention of the legislature in providing for carryforward and carryback loss deductions was to permit a City taxpayer to pay tax on an amount which more accurately reflects his true economic gain over a period of years. Such a provision might, presumably, be a factor in inducing a corporation to relocate or remain in the City.

“To adopt the City's construction of §2.0(8) would undermine this legislative intent. This is exemplified by Avien's situation here. Avien's true City income after January 1, 1966 consists of both losses and profits, a situation clearly within the purview of the carryforward and carryback loss provisions of the City tax law. Yet, according to the City, despite post-1966 losses, Avien must, nonetheless, pay City tax on its 1968 income because for federal tax purposes it used pre-January 1, 1966 losses.

“Rather, it seems clear the legislature intended that a City taxpayer should be given the same type of benefit allowed federal taxpayers, i.e., an averaging of income over a period of years during which the tax

was in effect. The reference in §2.0(8) to §172 of the Code is for general guidance and is not so inflexible as to require a non-intended result."

The impact and construction of a state taxing statute intended by the legislature to effect conformity with a Federal taxing statute is best and most recently illustrated in *Graham v. State Tax Commission*, — A.D.2d —, 369 N.Y.S.2d 863 (3d Dept., 6/26/75) where a non-resident of New York, filing a New York personal income tax return was denied, by the State, a net operating loss carryback or carryforward because of disparate accounting methods necessarily employed on the Federal New York non-resident returns. The Court, holding in favor of the taxpayer stated at 864:

"While the construction given statutes and regulations by an agency responsible for their administration, if not irrational or unreasonable, should be upheld (citing cases) and conformity of New York and Federal substantive tax provisions was a major objective of the Legislature when it reenacted the Personal Income Tax Law in 1960 (citing cases), strict conformity is impossible in the case of a non-resident since his Federal return reflects his New York as well as non-New York income whereas his New York return reflects only those items of income, gain, loss and deduction which are derived from or connected with New York sources (citing cases). Moreover, as petitioners point out, to deny a non-resident taxpayer a deduction on the basis of netting New York gains and losses with non-New York gains and losses ignores the statutory mandate that net operating losses be calculated solely with respect to New York items of income and losses.

* * * Accordingly, the regulation of the Tax Commission denying a non-resident taxpayer a net operating loss deduction by way of carry-back or carry-over, which deduction is based solely on income, gain, loss or deduction derived from or connected with New York sources, is unreasonable, arbitrary or capricious and, therefore invalid (citing cases), and any argument of Federal conformity is not sufficient to overcome such a conclusion."

The essence of the City's contention is that the debtor's net operating loss for City income tax purposes must be the "same as" the net operating loss taken on the federal return. The City construes the phrase "same as" as absolute and not subject to any deviation. Yet adoption of the City's strict interpretation would amount to, in this case, a forfeiture of carryover and carryback losses, a result which Judge Parente found "inconceivable" (51a). As Judge Parente noted (50a):

"The dominant thrust and the key to the court's opinion turns upon reasonable interpretation of the legislative intent in contrast to blind adherence to the language of a statute . . . in the matter of *American Can Company, Petitioner, v. State Tax Commission of the State of New York*, 37 A.D. 2d 649, 323 N.Y.S. 2d 6 (3d Dept. 1971), the court held as follows:

'When construing a statute the courts give great weight to the construction given it by the officers who are charged with the duties of endorsement (*Matter of Lawrence-Cedarhurst Bank*, 247 App. Div. 528, 288 N.Y.S. 301 Affd. 272 N.Y. 646, 5 N.E. 2d 374). The language as construed should not "be

at war with the plainest principles of reason and justice" (People ex rel. Burhans v. City of New York, 198 N.Y. 439, 448, 92 N.E. 18, 20).'"

Yet the language of the statute as construed by the City would indeed be at "war with the plainest principles of reason and justice."

In contra-distinction, the City argues at page 37 of its brief:

"The interpretation of the City and federal statutes sought by the debtor and adopted by the Court below thus makes a mishmash of the conformity with federal law which is the basic design of the New York State and City statutes, or perverts the obvious design of the federal law. It not only results in an anomalous situation for the year in which a given loss is substituted for one which is disallowed, but it also fouls up the calculation of the loss deduction in later years."

And again at page 40:

"We are not complaining about or seeking to avoid the onerous consequences of a ruling which would require more extensive auditing than the City now performs. The City does a certain amount of auditing of factors not entering into the federal return and is equipped to do this limited amount. We are merely pointing out that the structure of the law with its provisions for reporting federal changes points to the interpretation which we claim to be the correct interpretation of the definition of 'entire net income' and the treatment of the net operating loss deduction. That structure and the aim of the law is such that federal

conformity is its keynote. One of the more cogent reasons for federal conformity is to avoid the task of separate audit of the portions of the taxpayer's return which are reflected in its federal return and which will, in many instances, be subject to federal examination."

Stripped of all its verbiage, this is the City's real concern. When distilled to its ultimate simplicity, we submit that the City's position stems not so much from its view of the statute but instead from a fear that it will be saddled with increasing burdens. Yet what is wrong with this? Should a debtor in great financial difficulty and trying to rehabilitate itself for the benefit of all of its creditors have this "cross to bear"? After all, if the City chooses to impose a tax, it should bear the burden of collecting that tax. What the City has done is to impose a tax and has relied upon the federal government to do much of the work in collecting said tax. While this statutory scheme has received legislative sanction, the City takes it one step further by insisting that the debtor herein must report its identical losses for identical periods, a scheme not yet sanctioned by any legislative grace or judicial blessing. As Judge Parente noted (50a):

"The court finds the phrase 'same as' is *not cast in concrete as advocated by the City*. The language of the statute connotes a range of limitation in lieu of a complete bar or exclusion of the right to offset earned income by carryback or carryover losses . . . *the losses incurred by the debtor are, in the court's view, the 'same as' in component part if not identical to the tax reports filed with Internal Revenue.*" (Emphasis added.)

CONCLUSION

The order of the District Court and that of the Bankruptcy Court should in all respects be affirmed.

Dated: September 2, 1975

Respectfully submitted,

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